BALTIMORE COUNTY

ECONOMIC INDICATORS AND REVENUE REPORT

2000 Second Quarter

April 1 to June 30, 2000

Office of the County Auditor
September 21, 2000

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Second Quarter 2000 *Economic Indicators and Revenue Report*

Honorable Members of the County Council
Honorable C.A. Dutch Ruppersberger, III, County Executive
Baltimore County, Maryland

September 22, 2000

Gentleman:

Attached is the *Economic Indicators and Revenue Report* for the period April 1, to June 30, 2000.

Overall, the County's economy seems to have slowed somewhat in the second quarter of 2000 and with the U.S. and Maryland economies projected to soften, the County could face increased economic growth and revenue challenges in FY 2001 and 2002. From the second quarter of 1999 to the second quarter of 2000, County resident employment slipped slightly, but the actual unemployment rate fell. County resale housing and construction markets were also lower, and in some cases sharply lower, during the second quarter. A weaker home resales market causes selected real estate related taxes to fall.

FY 2000 General Fund revenues totaled $1,135.6 million, up $41.2 million or 3.8% over FY 1999; however, this was the smallest General Fund revenue increase since FY 1996. In FY 2000, property tax revenues increased by 4.0%, while income tax revenues increased by 3.6%. Sales and services revenues were up by 2.4% and "all other" revenues gained 4.5%. The FY 2000 surplus is estimated at $133.8 million. Given the estimated FY 2001 revenues and expenditures, the surplus at the end of FY 2001 is projected at $103.6 million, including $36.5 million in the Revenue Stabilization Reserve Account.

Should you have any questions or require additional information, please let me know.

Respectfully Submitted,

Brain J. Rowe, County Auditor

Paul R. Maihan, Senior Fiscal Analyst PRM

cc: Thomas J. Peddicord

BALTIMORE COUNTY
ECONOMIC INDICATORS REPORT

2000 SECOND QUARTER

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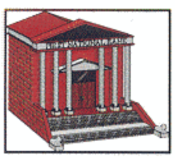
PART I
ECONOMIC INDICATORS

SUMMARY OF ECONOMIC INDICATORS

Baltimore County economic indicators for the second quarter of 2000 suggest a flat economy. County resident employment was flat/down slightly from a year earlier; however, the unemployment rate continues to fall due to a declining labor force. The County's housing and construction markets were also off from year earlier levels. ***Comparisons of the County's recent economic performance, coupled with a still favorable, but slowing outlook for the U.S. and Maryland economies, suggest increased challenges for County economic growth and revenues in FY 2001 and 2002.***

Employment among County residents fell by 384 persons, or by 0.1%, from 1999:Q2 to 2000:Q2, while the County **labor force** contracted by 1,716 persons, or by 0.4%. Due to the labor force contraction, the number of **unemployed** and the **unemployment rate** continued to show declines over the 1999:Q2 to 2000:Q2 period (pages 2-3).

Settlements on existing homes as well as **pending sales** fell by 4.9% and 3.2%, respectively, over the 1999:Q2 to 2000:Q2 period. For the first quarter of 2000, **residential** building permit activity was down sharply but most of the decline was due to reduced multi-family activity. **Non-residential** building permit activity was also off sharply reflecting a lack of large new construction projects, while additions, alterations, and repairs likewise showed a strong downward trend (pages 4-7).



Mortgage rates and other interest rates showed a mix pattern in the second quarter with some rates rising and others falling from the first quarter. After increasing interest rates six consecutive times, the Federal Reserve left short-term interest rates unchanged at their last two policy meetings on June 28 and August 22. There is some evidence that the U.S. economy is beginning to slow (pages 8-10).

Regional and **U.S. inflation** rates were up by 3.6% and 3.5%, respectively, from July 1999 to July 2000 (page 11). **U.S. economic growth** expanded at an annual rate of 5.3% in the second quarter of 2000, and was up by over 4% for three consecutive years, 1997 to 1999 (pages 12-13).

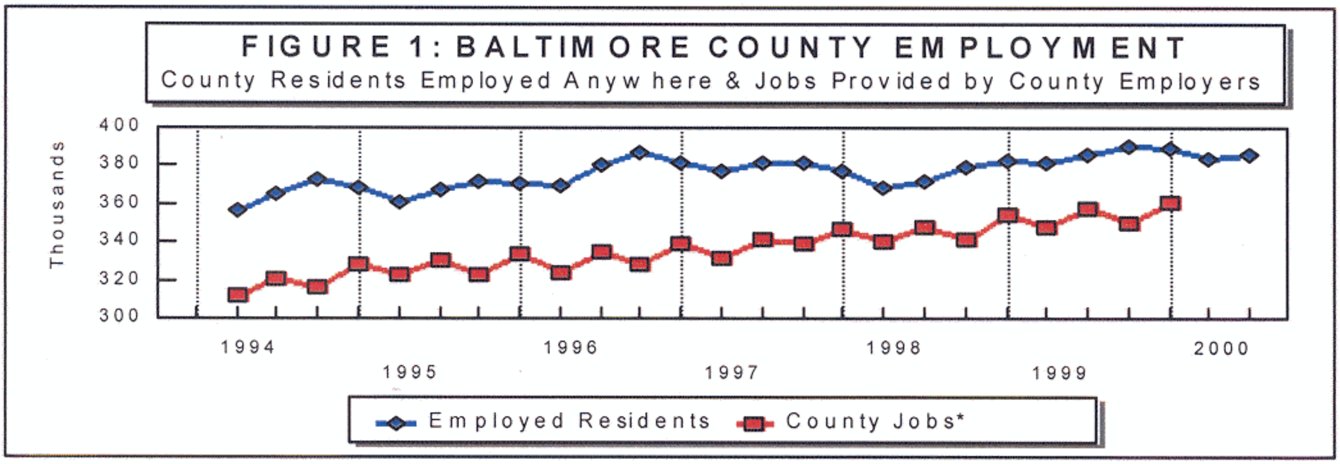
Consumer Confidence showed a modest decline in August and the index remains a little below the highs established in January and May. Overall, consumers seem poised to continue to support the current economic expansion, which is the longest on record at 114 months (page 12).

County General Fund revenues totaled $1,135.6 million in FY 2000, an increase of $41.2 million or 3.8%, the smallest advance since FY 1996. In FY 1999, General Fund revenues increased by 6.1% (pages 14-20). FY 2000 ended with an estimated surplus of $133.8 million. Given the estimated FY 2001 revenues and expenditures, the projected FY 2001 surplus is $103.6, including $36.5 million in the Revenue Stabilization Reserve Account.

ECONOMIC INDICATORS

EMPLOYMENT

Figure 1 shows quarterly employment levels for both County residents and County employers -- the former measuring the number of County residents employed, while the latter measuring the number of jobs supplied by County employers. Year-over-year comparisons show a relatively healthy but flat County labor market in 2000:Q2. From 1999:Q2 to 2000:Q2, County resident employment dropped by 0.1% or 384 person. This decline is in sharp contrast with the 13,786 person, or 3.7%, increase in resident employment a year earlier. The slight year-over-year employment contraction probably reflects, to some extent, the low availability of potential workers as the number of County unemployed residents reached an eleven year second quarter low of 14,617 and a slowdown in selected areas of the County's economy. Despite the fall-off in employment, the County's unemployment rate actually fell slightly from 1999:Q2 to 2000:Q2. County jobs over the 1998:Q4 to 1999:Q4 period rose by a solid 1.9% or 6,629 jobs (Figure 1).



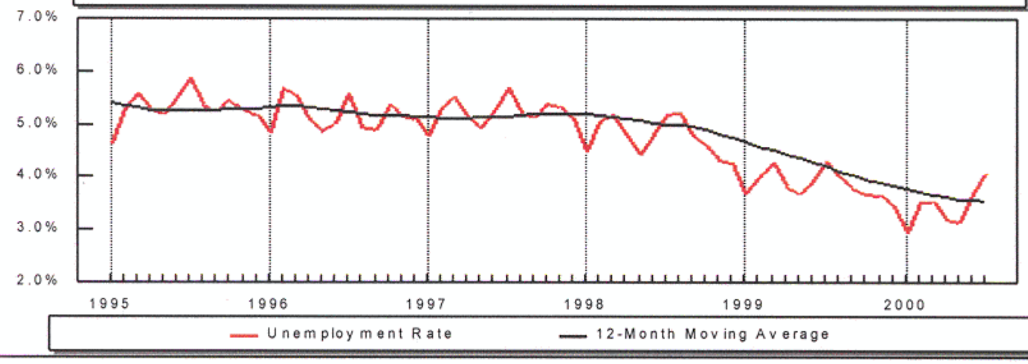
* County jobs data lags resident employment data by several quarters.

While the County employment picture perhaps dimmed a bit from it previous stellar performance, the State's performance in 2000:Q2 also slowed from the 1999:Q4 period when State resident employment was up 0.9%. The number of jobs in Maryland increased by 2.8% over the 1998:Q4 to 1999:Q4 period.

The County's total resident employment during 2000:Q2 averaged 385,261 persons -- only slightly below the record second quarter reading in 1999. Despite the small year-over-year employment decline, the number of **unemployed** County residents dropped by 1,369 persons, or by 8.6%, over the 1999:Q2 to 2000:Q2 period. Over the last two years, the number of unemployed County residents dropped by an impressive 4,193 persons or by nearly one quarter. In 2000:Q2, only 14,617 County residents, out of a labor force of 399,915, remain unemployed. Labor force data might be an early indication that the County's population is stagnate or perhaps actually declining. The slight year-over-year County employment contraction, coupled with a bigger reduction in the labor force (0.4% or 1,716 persons) is in sharp contrast to developments Statewide where both employment and the labor force expanded. Both employment and labor force numbers are generated by place of residence and while these numbers are subject to revision, if true, this could slow the future stream of income tax revenues to the County.

Baltimore County's **unemployment rate** averaged 3.7% in 2000:Q2 -- down from the 4.0% and 4.8% average in 1999:Q2 and 1998:Q2, respectively (Figure 2). The decline of 1.1 percentage points in the County's unemployment rate over the last two years reflects the addition of over 13,400 employed residents (all occurring over the 1998:Q2 to 1999:Q2 period), while the labor force increased by only 9,246 persons. Even if the economy continues to be strong (economic growth in the U.S. has averaged 4.0+% over the last three years and was running at a 5.0% annual rate thus far in 2000), County employment growth might be challenged due the low availability of workers. There is a "natural rate of unemployment" thought to be around 3-4% of the labor force. This natural rate means that there will always be individuals counted as unemployed due to any number of factors including labor force transition, seasonal influences, new labor force entrants, etc. Thus, future year-over-year County employment comparisons show weakness.

FIGURE 2: BALTIMORE COUNTY UNEMPLOYMENT RATE



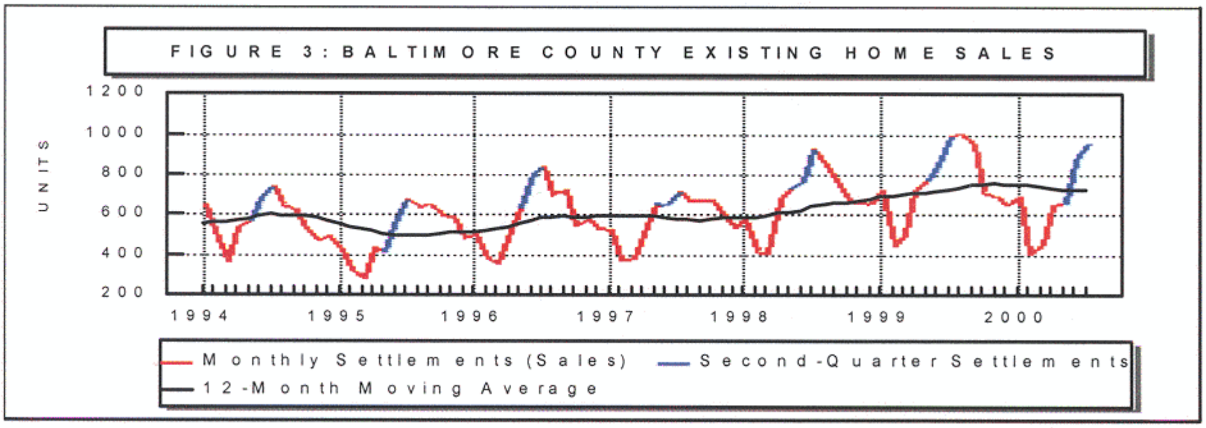
Historically, the County's unemployment rate has generally been a little higher than the State's; this trend continued in the second quarter. In 2000:Q2, the State's unemployment rate averaged 3.6% compared to the County's 3.7%. In June, the State and County recorded unemployment rates of 3.6% and 4.1%, respectively, both down slightly from June 1999. For comparison, the current (August) U.S. unemployment rate was 4.1% -- near a 30+year low rate of 3.9%.

June 2000 unemployment rates varied considerably throughout Maryland with Baltimore County ranking 16th Statewide out of Maryland's 24 jurisdictions (including Baltimore City), Statewide unemployment rates varied from 2% or below in Montgomery, Howard and Frederick counties, to above 6% in Garrett, Somerset, Dorchester and Allegany counties and Baltimore City. Baltimore City's had the highest unemployment rate at 7.9%.

For the Baltimore Metropolitan Area (BMA), the County's unemployment rate of 4.1% ranked second highest and only slightly below the BMA June average of 4.3%, which is strongly influenced by Baltimore City. In fact, if the City's employment data were excluded, the June 2000 BMA unemployment rate would have been only 3.2%. Harford County was the only other BMA county that would have had an unemployment rate above the regional average, excluding Baltimore City. Moreover, from June 1999 to June 2000, Baltimore County and Baltimore City were the only two BMA jurisdictions to show employment declines. Thus, while Baltimore County's labor markets seem to be performing reasonably well, after excluding the City's data, it lags well behind the regional employment performance.

HOUSING

Existing-home sales data for Baltimore County over the 1994 to 2000:Q2 period are presented in Figure 3 below. Annual existing home sales in the County have generally been trending upward over the last eight years and in 1999, set a record at 9,021 units -- around 20% above the 1995-99 average. However, for the 2000:Q2 period, County existing home sales slipped below the comparable second quarter period for the first time since 1997, but still remain comfortably above the average second quarter sales level for the last five years. Thus, while sales are slowing reflecting higher mortgage rates and lower availability, they still remain relatively strong.



Starting in November 1999 and continuing through the first six months of 2000, existing home sales fell below year ago levels. County existing home sales in 2000:Q2 were 4.9% below the 1999:Q2 period -- 2,495 units versus 2,624 units, and for the first six months of 2000 were 6.9% below the comparable period. These declines in existing home sales reflect two factors -- first, rising mortgage rates with the 30-year conventional mortgage rate in 2000:Q2 averaging 8.3% -- 110 basis points ahead of the 1999:Q2 average of 7.2%; and, second, the inventory of available existing homes for sale in the County in 2000:Q2 was at the lowest comparable quarter in the data series history (1992 to present) and 18.8% below 1999:Q2. While mortgage rates have eased somewhat, and in early August were 20 basis points below the second quarter average, the lack of a strong inventory of available homes for sale will likely persist and will be affecting future County existing home sales.

	Existing Home Sales		30-Yr. Conventional Mortgage Rate	
	Annual	Second Quarter	Annual	Second Qtr. Avg.
1993	6,632	1,633	7.3	7.5
1994	6,632	1,944	8.4	8.4
1995	6,185	1,666	8.0	8.0
1996	7,144	2,277	7.8	8.1
1997	7,040	2,032	7.6	7.9
1998	8,291	2,434	6.9	7.1
1999	9,021	2,624	7.4	7.2
2000	n.a.	2,495	n.a.	8.3

Pending existing-home sales within the County are presented in Figure 4 below. In a 2000:Q2 pending County home sales were down by 3.2% on a year-over-year basis; however, they still remain at historically high levels. The decline in pending sales probably reflects higher mortgage interest rates and the low inventory level of homes for sale. Traditionally, a small increase in mortgage rates will not have an immediate impact on home sales, but the 30-year conventional mortgage rate has been creeping up over the last 18 months, and over time rising mortgage rates dissuade marginal buyers and slow the move-up part of the market. The 110 basis point increase in the conventional mortgage rate over the last year, coupled with a 3.0% increase in the average selling price of a County home from June 1999 to June 2000, has added $139 (a 14.5% increase) to the monthly principal and interest payment for the average priced County home, financed with a 30-year fixed rate mortgage, with a 10% down payment.

FIGURE 4: BALTIMORE COUNTY PENDING EXISTING HOME SALES

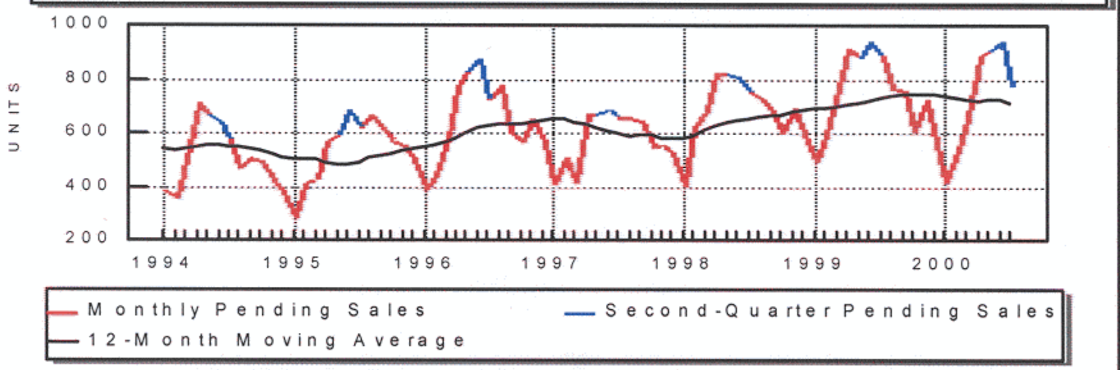
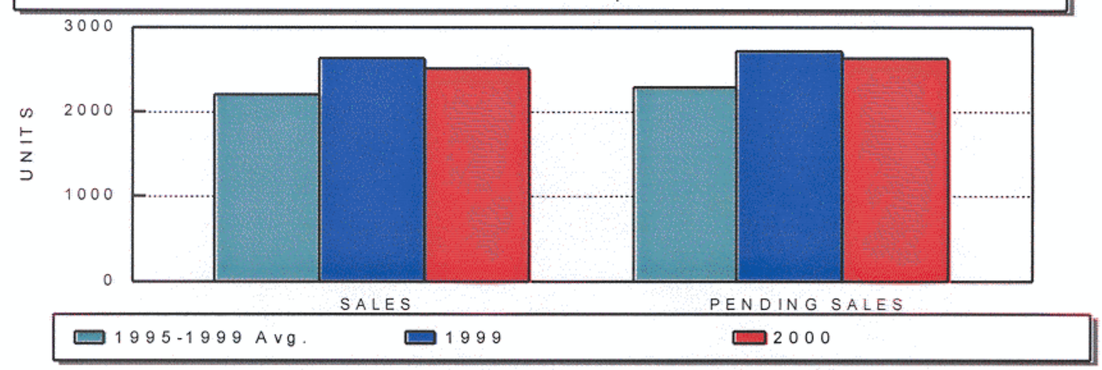
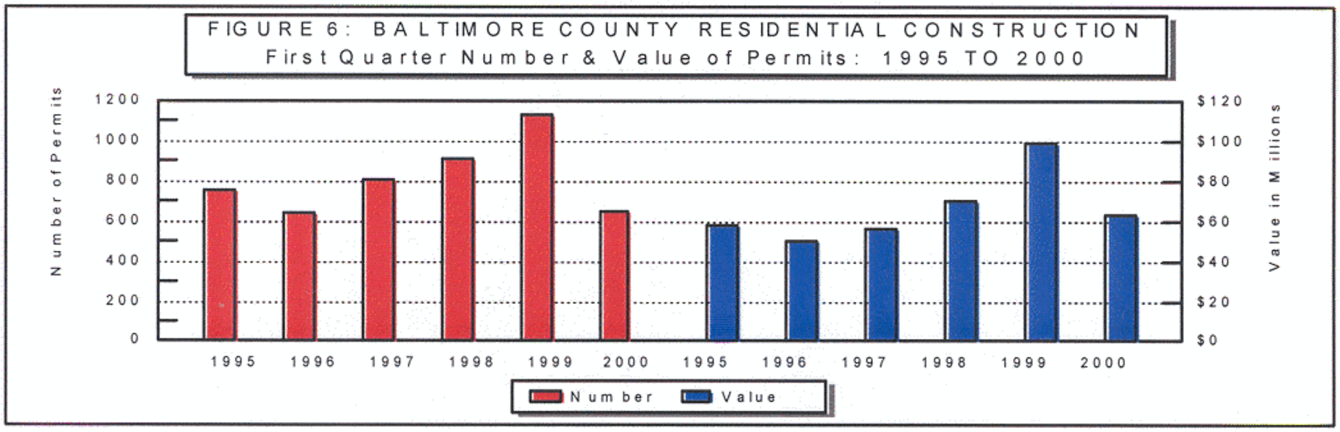


Figure 5 shows a longer term perspective of the current strength of the Baltimore County residential housing market. Despite the recent slowing in existing home sales and pending sales, the County's overall housing market is relatively strong and will likely continue, albeit at a slightly lower level in 2000 and 2001 versus a record setting year in 1999. While 2000:Q2 existing home sales and pending sales are down from the corresponding 1999 period, 2000:Q2 sales and pending sales are still ahead of the 1995-99 second quarter average by 13.0% and 14.7%, respectively.

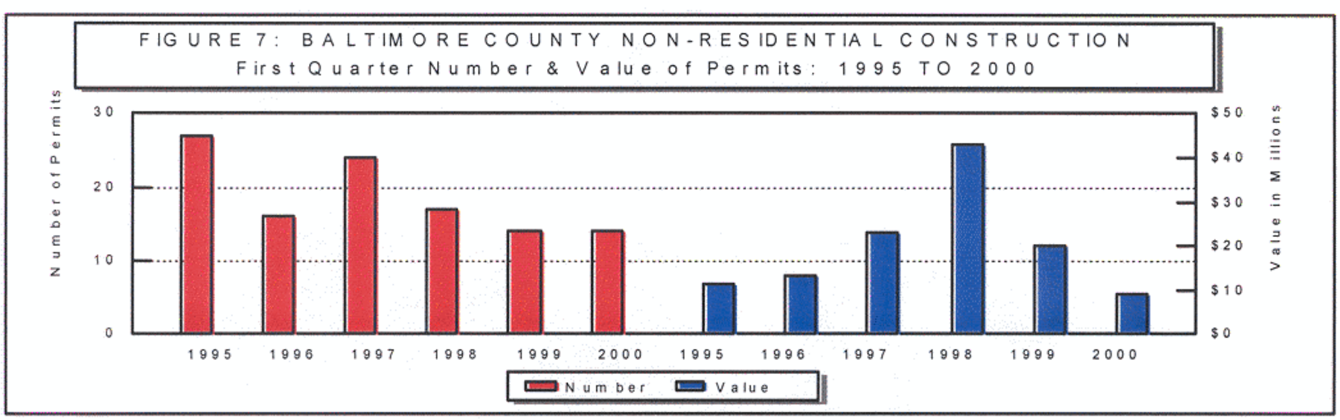
FIGURE 5: BALTIMORE COUNTY EXISTING HOME SALES & PENDING SALES
Second Quarter Comparisons



Baltimore County building activity slowed across the board in early 2000 with residential, nonresidential, and additions, alterations and repairs all showing sharply lower values compared to the previous few years. Figure 6 shows the number and value of County **residential building permits** for the first quarter period from 1995-2000. While three months is a relatively small observation period, the **number** of new residential building permits issued in 2000:Q1 was down by 41.9% and 28.3%, respectively, from the comparable period in 1999 and 1998. The combined **value** of residential building permits in 2000:Q1 compared to 1999 and 1998 was down by 36.0% and 9.8%, respectively. Most of the weakness has been in the more volatile multi-family housing sector. If only single family housing is considered, 2000:Q1 new residential building permits were down by 13.2% and 1.1% compared to the similar 1999 and 1998 period, respectively.



New **non-residential building activity** (commercial and/or industrial, private and/or public) provided a strong plus to the County's economy in 1999, but through the first quarter of 2000 has shown little strength (Figure 7). In 2000:Q1, the value of non-residential construction building permits issued in the County was $9.1 million, down by 54.6% and 78.8% over the healthy comparable 1999 and 1998 period, respectively. New non-residential building activity is dependent on specific projects that can make this economic data set volatile. Fewer permits were issued for new projects in 2000:Q1 compared to the previous two years perhaps reflecting the wet winter, a general construction slowdown, and/or higher interest rates. A few 2000:Q1 new projects include: a $2.8 million office/warehouse facility in Lochearn, a $2.5 million school and synagogue in Reisterstown/Owings Mills, a $1 million car dealership in Cockeysville, a 3-story office/mixed use building in Perry Hall, and a $600,000 church in Lochearn.

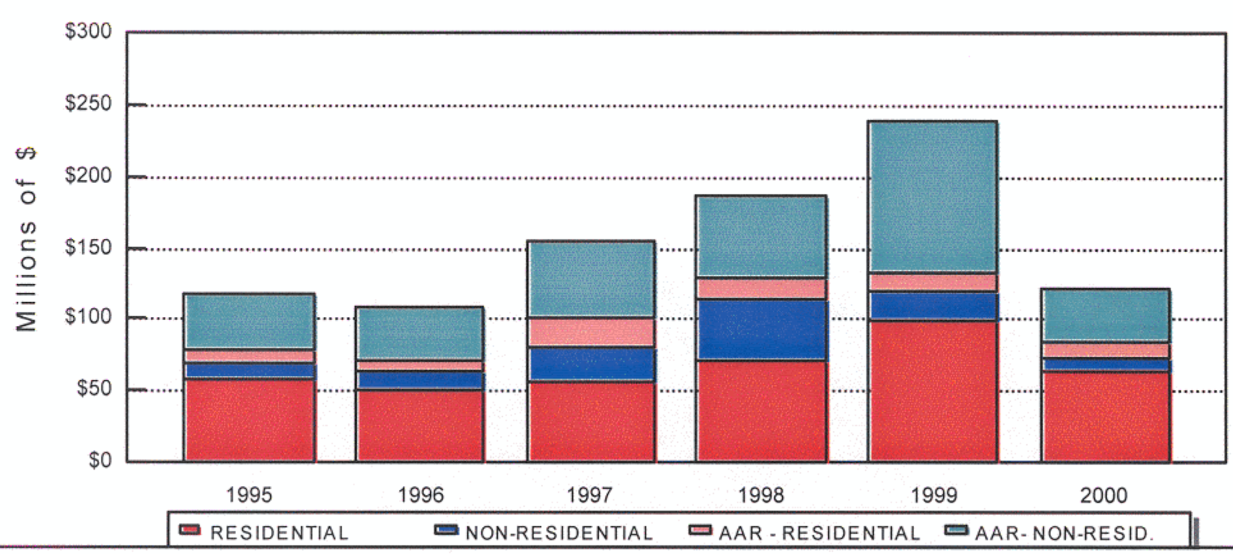


A key component in overall construction permit activity, **additions, alterations, and repairs (AAR)** accounted for $50.4 million or 41.0% of the total value of construction permits in the County in the first quarter of 2000 -- around the average AAR percentage in the last five years. The $50.4 million in 2000:Q1 AAR activity consisted of $12.5 million in residential and $37.9 million in non-residential permits. Overall, the 2000:Q1 period for aggregate AAR activity was down a strong 57.8% and 31.5% from the respective period in 1999 and 1998. A few of the major AAR projects approved in the first quarter 2000 included:

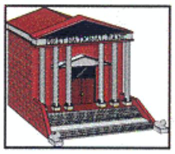
Value	Facility	Area
$1.4 million	Alterations to Giant Supermarket	Towson
1.2 million	Sprinkler System in Mfg. Plant	Perry Hall/White Marsh
0.8 million	Interior Alterations to Office	Lutherville
0.8 million	Addition to Industrial Building	North Point
0.7 million	Three Story Convent Addition	Ruxton

The **total** value of all construction permits issued in Baltimore County in the first quarter of 2000 was $122.9 million -- down 48.4% and 34.2%, respectively, over the comparable 1999 and 1998 period (Figure 8). Thus, early 2000 indications suggest that the total construction market in the County may be weakening after several years of impressive strength. Whether the market is only taking a breather to allow absorption of the new capacity put in place over the last several years, or this is the beginning of a broad-based show down in a maturing markets will require close observation.

FIGURE 8: BALTIMORE COUNTY CONSTRUCTION
First Quarter Value of Permits by Type of Construction - 1995 to 2000



MORTGAGE AND OTHER INTEREST RATES



At the last two Federal Reserves' Federal Open Market Committee (FOMC) meetings on August 22 and May 16, interest rates were left unchanged. Since June 30, 1999, the FOMC increased short-term interest rates (federal funds rate) six times in an attempt to slow the economy's growth rate as a preemptive strike against inflation. The FOMC's August 22 inactions still left the federal funds rate at 6.5% -- a nine year high. The federal funds rate is a main variable that major financial institutions use in setting their prime business lending rate, consumer loan rates, and to a lesser extent, long-term mortgage lending rates.

While the FOMC left interest rates unchanged at their last two meetings, they did indicate that the latest round of interest rate increases might not be the last. But some economists see the current level and interest rate structure as a point of concern. Changes in the aggregate economy, as a result of change in interest rates, are variable in length and uncertain in magnitude. No one knows how high interest rates will have to go before the economy slows to the 3.0-3.5% growth rate that the FOMC would like to engineer. If current interest rate levels begin to affect more consumer and business spending decisions, the economy could slow sharply or even contract. In that environment, negative consequences abound, from falling local tax receipts to an increase in the unemployment rate.

There is some evidence of a broad-based slowdown developing at the national level. Nationally, housing starts and new home sales have declined in recent month, (but they are recording relatively small declines from previous records), and new factory orders fell sharply in July. Moreover, the aggregate employment picture has been stagnate. In June, only 30,000 jobs were created; in July and August total employment actually fell for the first time since January 1996, but the declines reflected special factors, notably temporary Census workers leaving the workforce and the Verizon strike. The January 1996 employment decline was weather driven. Despite scattered signs that parts of the economy are showing, second quarter real output in the U.S. expanded at a 5.3% annual rate, up from the first quarter pace of 4.8%.

Interest Rates

	90-Day Treasury Bills	10-Yr. Treasury Bonds	30-Yr. Conven. Mortgage	30-Yr. Mortgage less 10-Yr. T.B.
1998: Q2	5.11	5.60	7.09	1.49
1998: Q3	4.96	5.20	6.86	1.66
1998: Q4	4.37	4.67	6.77	2.10
1999: Q1	4.53	4.98	6.88	1.90
1999: Q2	4.59	5.54	7.21	1.67
1999: Q3	4.79	5.88	7.80	1.92
1999: Q4	5.20	6.14	7.83	1.60
2000: Q1	5.70	6.48	8.26	1.78
2000:Q2	6.00	6.20	8.32	2.14
August 25	6.29	5.75	7.99	2.24

Source: Federal Reserve Board

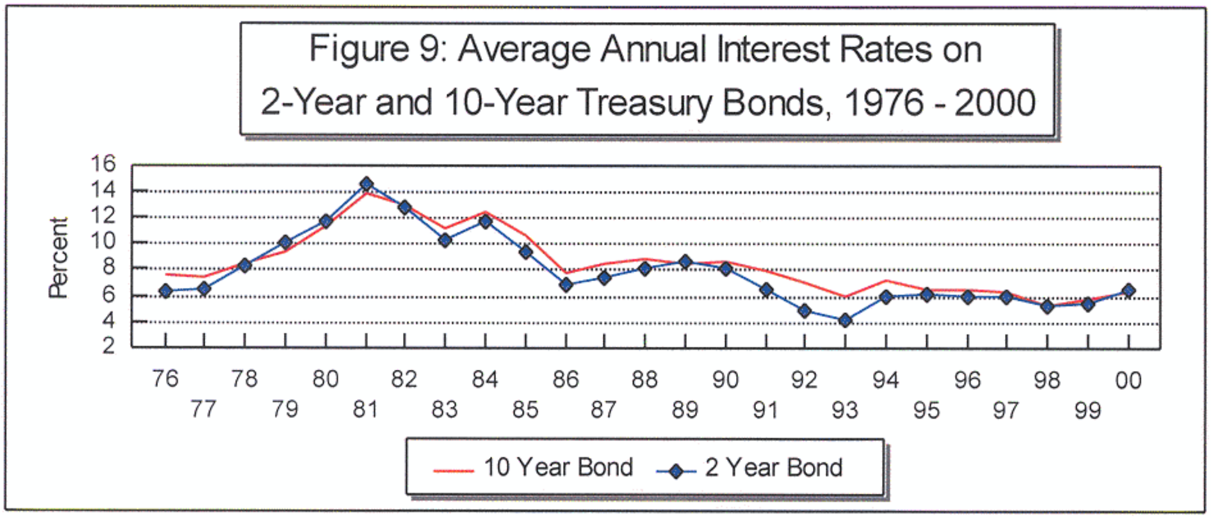
The interest rate table on the previous page illustrates the magnitude and composition of recent interest rate increases over the last several years. Short-term 90-Day Treasury Bills in 2000:Q2 averaged 6.00%, up 30 basis points from the first quarter, and 141 basis points above 1999:Q2. As of August 25, the benchmark 90-Day Treasury Bill rate was 6.29% -- up another quarter plus percentage point from the 2000:Q2 average. Compared to the 90-day Treasury Bill, the rise in the 10-year Treasury Bond over the last year was much less dramatic with the 10-Year Bond increasing by 66 basis points from 1999:Q2 to 2000:Q2, and actually declining by about a quarter of a percentage point from the 2000:Q2 average to present (directly opposite of the 90-Day Treasury Bill).

The pattern of interest rate movements since June 30, 1999 (the FOMC's first-of-six interest rate increases) suggests that markets overall are not currently viewing long-term inflation as a threat. From June 30, 1999 to August 25, 2000, the benchmark short-term interest rate, the 90-Day Treasury Bill, has risen 152 basis points, almost equivalent to the total FOMC's increase in the Federal Funds rate of 175 basis points. But, the 10-Year Treasury Bond rate has actually fallen by 12 basis points, while the 30-Year Conventional Mortgage rate has risen by only 28 basis points. Thus, while the Federal Reserve has control over short-term interest, long-term rates are controlled by exogenous market force. Given the current long-term interest rate pattern, the market is suggesting that inflation is not likely to be a threat to the economy. If inflation were viewed as a threat, long-term interest rates would be moving in lock-step with short-term interest rates, causing the economy to slow even more. But, while the markets do not seem to be frightened by the prospects of sharply higher inflation, markets might be suggesting that a significant broad-based slowdown in U.S. economic growth is in the offing.

The Inverted Yield Curve -- A Sign of Trouble Ahead?

This subject was addressed in the first quarter *Baltimore County Economic Indicators Report* and since it has potential important implications for County revenues, it is worth revisiting. One troubling aspect of the recent pattern of interest rates is that normally, long-term interest rates are greater than short-term interest rates (normal yield curve), since investors demand greater compensation for the risk incurred in owning longer term securities. During infrequent periods when short-term interest rates exceed long-term interest rates (inverted yield curve), the market is indicating that debt issuers expect long-term interest rates to fall. Falling long-term interest rates usually occur when: 1) the economy is expected to contract or is contracting, or its growth rate is expected to slow or is slowing considerably, or 2) inflation expectations are declining. An August 2000 survey by the Federal Reserve Bank of Philadelphia indicates that inflation expectations are flat to slightly higher, not falling. Consequently, the current interest rate structure implies the economy will be slowing and/or contracting. If the slowdown is too sharp or an actual contraction occurs, the implications for County revenues are negative.

Figure 9 on the following page shows the annual average interest rate on 2-year and 10-year Treasury Bonds, from 1976 to 1999 and for the average of 2000 through July. Data show that, over this period, the yield curve inverted twice (short-term rates > long-term) and stayed inverted for a year or more, and twice the economy sank into a recession. The yield curve first inverted in 1979 and remained inverted during 1980 and 1981. From January 1980 to November 1982, a 34 month period, the U. S. economy was in recession for 22 months. Likewise, the yield curve inverted in 1989 and the U.S. economy witnessed a contraction from July 1990 to March 1991. The 2-year versus 10-year Treasury yield curve inverted in February 2000 and has remained inverted through late August.



* 2000 data are through July

County Revenue Implications:

While no one is currently forecasting recession in 2001, markets seem to be betting that the FOMC will engineer a slowdown from the economy's current 5+% growth rate to a more sustainable, lower inflationary, growth rate of around 3%-3.5%. However, history teaches that the timing and magnitude of the impact of changing interest rates, especially rising rates, on the economy is uncertain. In a rising interest environment, even a small exogenous shock to the economy could cause significant problems, very much like in 1990/1991 when an oil shock tipped the U.S. into recession. Regardless, if the FOMC is successful and engineers a "soft landing" for the economy, i.e., slower growth without a recession, it is important to remember that as the U.S. economy slows, the growth rate in County revenues will also slow. On the other hand, if the FOMC goes too far with interest rate increases and the U. S. economy contracts, County revenues could also contract.

Current Baltimore County data show a flat employment picture from a year ago, sales of existing single family homes in the County over the last eight months are down on a year-over-year comparison, and for the first quarter 2000, data show a deteriorating residential and non-residential construction market in the County. With the 30-year conventional mortgage rate in 2000:Q2 up by over a full percentage point from a year earlier and 150 basis points above 1999:Q1, it is not surprising that County real estate and construction markets have softened. How do these developments impact County revenues? A flat employment picture suggests little growth in income tax revenues, a softer residential resale market would suggest a decline in County recordation and title transfer taxes, and a weak construction market might indicate a slower growth rate in property tax revenues. Even on a more aggregate basis, few residential resales would mean lower capital gains, and hence reduced consumer spending power that fuels two third of the U.S. economy.

Currently, the Auditor's Office is forecasting that County revenues will grow by 3.7% in FY 2001, a little below the 3.8% increase in FY 2000 and the lowest revenue growth rate since FY 1996. The Administration is forecasting FY 2001 revenue growth of only 2.6%. (See Table on page 19).

INFLATION

The Consumer Price Index (CPI) for the Washington-Baltimore Consolidated Metropolitan Statistical Area over the July 1999 to July 2000 period, increased by 3.6%, a little ahead of the U.S. inflation rate of 3.5% over the same period. The July 1999 to July 2000 CPI increase is running well ahead of the comparable 1999 and 1998 periods when the CPI, at the national level, was up 2.1% and 1.7%, respectively. However, the current inflation rate is actually below the year-over-year highs recorded in May. Current inflation rates can no longer be described as modest and are at levels not experienced over the 1990's, but are well below 1980's levels.

Financial markets respond quickly to inflationary trends. Usually, increasing inflation puts upward pressure on interest rates, especially at the long end of the market as investors attempt to capture stable real returns. But since long term interest rate have actually been declining since the 2000:Q1 average, financial markets believe that the worst year-over-year inflation comparisons have already occurred. In fact, the U.S. “core” inflation rate (CPI less the more volatile food and energy sectors) is up 2.4% on a year over year basis. From July 1999 to July 2000, energy prices are up by over 19% and with energy prices expected to stabilize or even head slightly lower, the worst inflation numbers for the year have probably been already posted. However, this is not to suggest that inflation will be benign and that the Federal Reserve has finished increasing interest rates. World demand is growing and a still strong U.S. growth, coupled with low unemployment has pushed up average hourly earnings at 3.8% annual rate. However, strong second quarter productivity gains actually pushed unit labor cost down for the quarter. While the 5.3% productivity gain was indeed impressive, the question remains: were these structural productivity gains due to increasing use of computers and the Internet, or were these gains transitory, driven in part by companies not being able to fill vacant positions. If the latter, second quarter productivity gains will quickly vanish.

Inflation forecasts are being revised upward for 2000. The Federal Reserve Bank of Philadelphia’s *Survey of Professional Forecasters,* taken in February, in May and again in August 2000, show that survey participants raised their 2000 inflation (CPI) expectations from 2.5%, to 3.1%, to the current forecast of 3.3%. According to the same survey, the CPI for 2001 is forecast to increase by 2.8%.

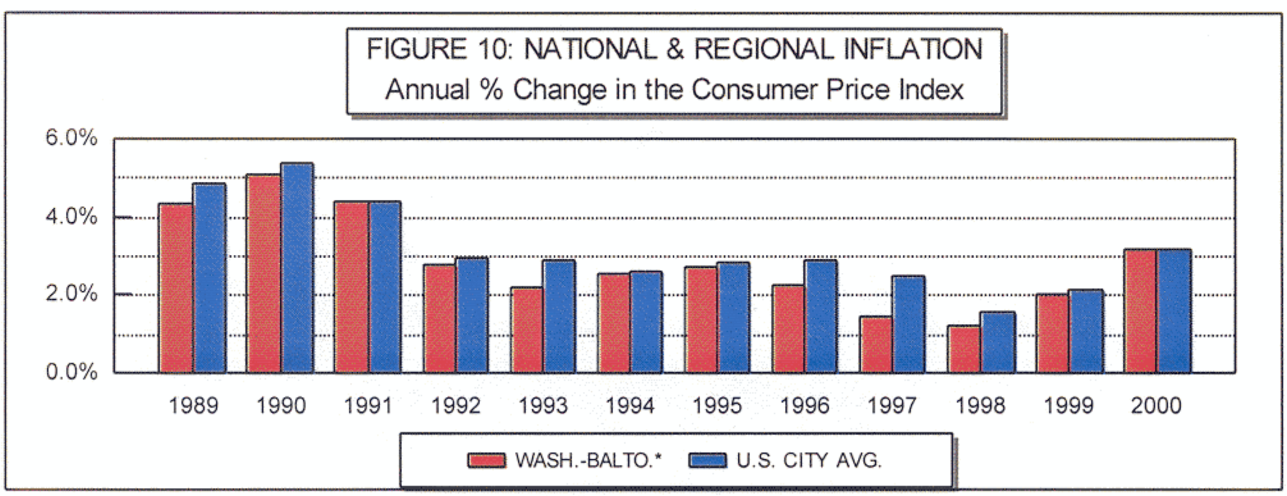


FIGURE 10: NATIONAL & REGIONAL INFLATION
Annual % Change in the Consumer Price Index

CONSUMER SPENDING

Fueled by increasing wages, strong personal income growth, and a high level of consumer confidence, real personal consumption expenditures, which accounts for around two thirds of all economic activity, expanded at a 2.9% annual rate in the 2000:Q2, down sharply from the 2000:Q1 pace of 7.6%. Despite the slowing in real personal consumption expenditures, the U.S. economy expanded at a 5.3% annual rate with nearly a third of the increase coming from business spending on information processing equipment and software. Thus, it appears that monetary policy is in fact working as the textbooks would suggest. The cost of capital rises and begins to slow consumer spending, while at the same time accelerates spending on items that improve economic efficiency by more than the cost of capital. While the 5.3% annual growth rate in 2000:Q2 is clearly unsustainable and makes the Federal Reserve nervous about the inflationary implications, some economist indicated that the type of growth that is occurring will determine if strong growth is inflationary. Economists distinguish between consumer demand-led growth, which can push up prices as too many dollars chase too few goods, and supply-led growth that expands the economy's capacity to produce. Clearly, 2000:Q1 growth was consumer-led, while 2000:Q2 was more supply-led. What pattern will prevail will determine the Federal Reserve's response.

In August, the U.S. unemployment rate rose slightly to 4.1% -- just off a 30-year low set in April at 3.9%. July's and August's employment report showed that special factors pushed total U. S. employment down by 51,000 and 105,000 jobs, respectively. While the private sector created jobs in both July and August, this was more than offset by the departure of temporary federal Census workers. This was the first time since January 1996 that U.S. economy failed to show positive employment gains when weather related factors also caused total employment to contract. In June 2000, a modest 30,000 jobs were created.

Despite the recent aggregate employment drop, jobs remain abundant and consumer sentiment remains at high levels. In a recent survey of 5,000 households, a record low 9.9% of those surveyed said that jobs were "hard to get", while the percentage describing jobs as "plentiful" was 55.1%, just slightly below the January record level. The **Index of Consumer Confidence*** set a record in January but slipped slightly in February and March, recovered slightly in April, rebounded convincingly in May, fell again in June, and rebounded strongly in July before slipping again in August. Currently, the Index's "Present Situation Index" is just below the July record reading, while the overall "Confidence Index" is a little below the record levels recorded in January and May 2000. Overall, U. S. consumers are upbeat in their outlook for the economy in spite of recent stock market volatility and interest rate increases. According to the Conference Board, the private group that publishes the Index of Consumer Confidence, "most people expect the strength of the labor market to continue six months down the road, and that has them feeling confident things are on the right path."

Given the U.S. economy's impressive second quarter and first half 2000 performances, most economic forecasters have been increasing their 2000 forecast for Real Gross Domestic Product (GDP), the broadest measure of U.S. economic output. In February, consensus GDP forecasts from the National Association for Business Economics and Federal Reserve Bank of Philadelphia were indicating that real GDP will expand by a little less than four percent in 2000.

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* This particular gauge is important in evaluating the economy's future since consumer spending accounts for about two-thirds of overall economic activity. The more confident the consumer, the more likely they will continue to spend and propel the economy forward.

(From a historical perspective, Real GDP expanded by four percent or more over the last three years. In 1999 and 1997, GDP increased by 4.2% and, for 1998, 4.3% -- a remarkable achievement at this stage of the economic cycle.) But with 2000:Q2 GDP up at a 5.3% annual rate, following a 4.8% growth rate in 2000:Q1, economists surveyed by the National Association of Business Economics in May and by the Federal Reserve Bank of Philadelphia in August have raised their 2000 GDP growth forecast to 4.9% and 5.2%, respectively.

A GDP growth rate of 5%+ will likely foster new job creation above labor force expansion, thus potentially pushing the U.S. year-over-year unemployment rate down further and adding to already existing wage pressures. But if productivity gains continue strong, increased wage demands might not be a problem since unit labor costs will be benign. However, if recent productivity increases prove transitory, wage pressures will translate into inflationary pressure and additional Federal Reserve interest rate increases.

While GDP growth projections for 2000 are being revised upward, projections for 2001 are being revised downward to around three percent. This sharp fall off in the U.S. economy's rate of growth and the County's slower growth rate could potentially impact County's revenue prospects for FY 2001 and FY 2002. Already, FY 2000 County revenues were a little below expectations due to lower than anticipated income tax revenues, especially the final State distribution in June. These lower than expected income tax revenues might partly reflect lower County employment numbers. Regardless, the uncertainty surrounding the pace and direction of local economic growth will make revenue forecasting more challenging.

PART II
REVENUES

BALTIMORE COUNTY REVENUE REPORT
FISCAL YEAR 2000 REVIEW AND FY 2001 OUTLOOK

Fiscal Year 2000 Review

Total Revenues Up 3.8% in FY 2000

☞ *County General Fund revenues in FY 2000 totaled $1,135.6 million, an increase of $41.2 million or 3.8% over FY 1999. This gain comes on top of the $62.7 million or 6.1% increase in FY 1999 and represents the smallest General Fund revenue increase since the 3.1% gain in FY 1996.*

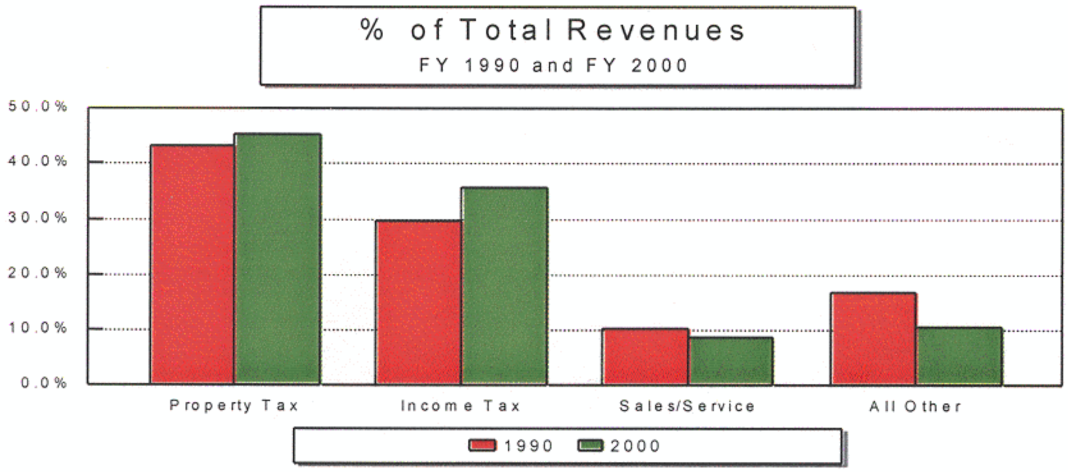
☞ *Most of the FY 2000 General Fund revenue increase came from higher property tax revenues, followed by income taxes, "all other" and sales and services taxes. (See distribution below). Property tax revenues in FY 2000 were up $17.9 million and accounted for 43.5% of the revenue gain. Higher property tax revenues reflected the County's strong construction performance in early portion of FY 2000 as well as rising County real property values. Income tax revenues in FY 2000 increased by $13.9 million and accounted for a little over one third of County revenue growth. While County resident employment was flat from June 1999 to June 2000, rising personal income, coupled with continued realized capital gains, kept income tax revenues strong. (However, final data on personal income and capital gains will not be available for several years). It is interesting to note that in FY 1999, income tax revenues accounted for the lion's share of the revenue gains, followed then by property taxes.*

Revenue Gains and Sources: FY 2000 Over FY 1999
(Millions of Dollars)

Revenue Source	Revenue Gain	% of Total Increase
Property Tax	$17.9	43.5%
Income Tax	13.9	33.7
All Other	6.9	16.8
Sales & Services Taxes	2.5	6.1
Total Revenue Gain	$41.2	100.0%

☞ *In FY 2000 property taxes accounted for 45.1% of County revenues; income taxes, 35.6%; sales and services taxes, 8.7%; and "all other" accounted for 10.6% of all revenues. Thus, the combined property tax and income tax revenue represented nearly 81% of total revenues.*

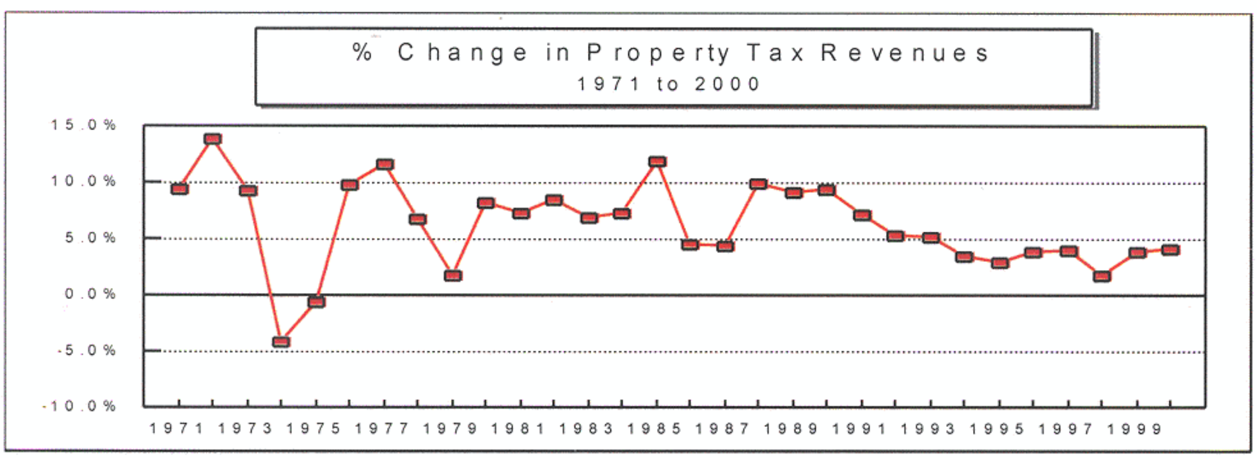
☞ *Over the past decade, there has been a growing reliance on revenue generation from property and income taxes. In FY 1990 and FY 2000, respectively, property tax revenues were 43.3% and 45.1% of total revenues; income taxes were 29.5% and 35.6%; sales and service taxes were 10.3% and 8.7%; and "all other" were 16.9% and 10.6% of County General Fund revenues (See bar graph next page).*



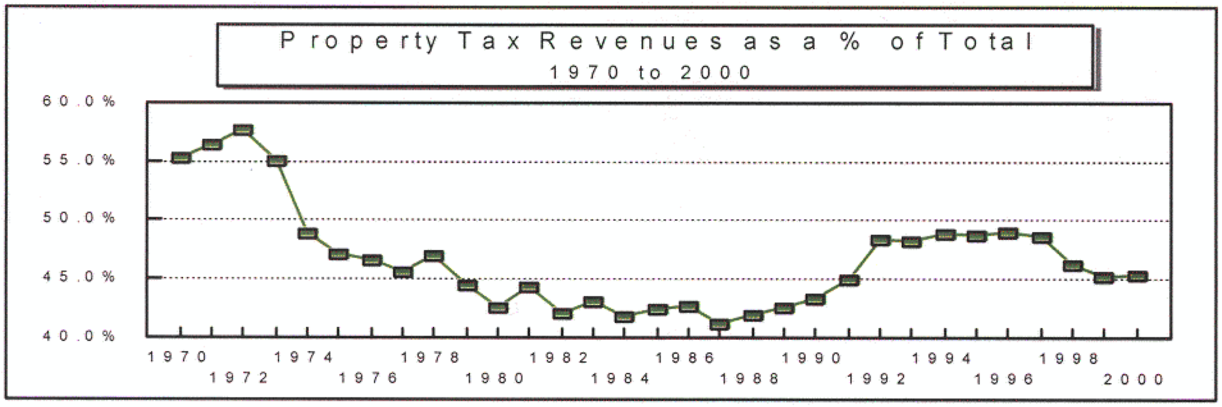
Property Tax Revenues Up 3.6% In FY 2000

☞ *Property tax revenues totaled $512.2 million, an increase of $17.9 million or 3.6% over FY 1999. The FY 2000 increase in property tax revenues was the second weakest over the most recent 5-year period with only FY 1998 lower at 1.7%. Over the last five-year and ten-year period, respectively, property tax revenues have increased by an average of 3.5% and 4.1%. Thus, while property tax revenues were a little stronger in FY 2000 than they have been in the last 5-year average, they were only a little above the recent 5-year average and actually a little below the 10-year average. (See graph below).*

Percent Change In Property Tax Revenues: FY 1971 to 2000



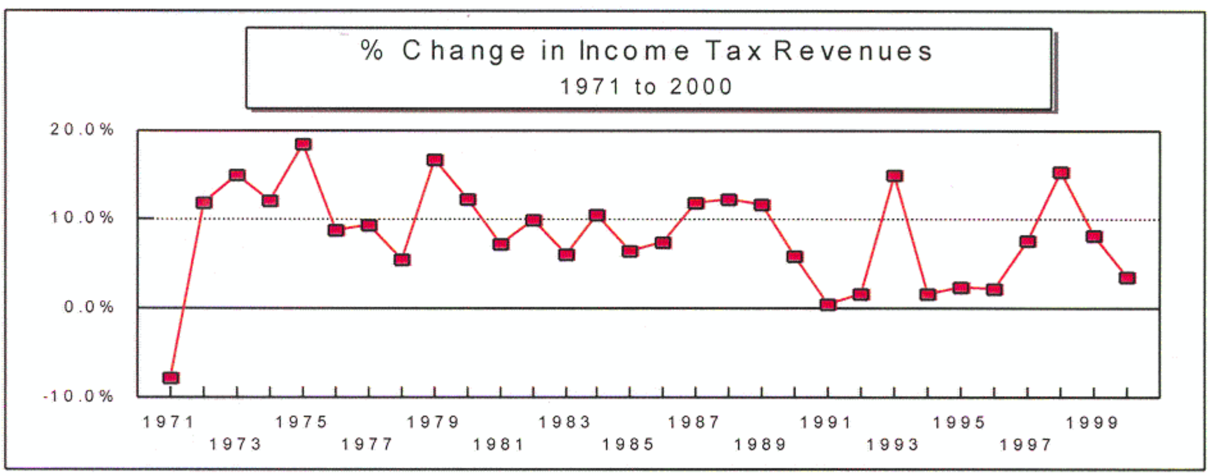
☞ *In FY 2000, property tax revenues accounted for 45.1% of total County General Fund revenues, down 1.8 percentage points from the FY 1990-FY 2000 average of 46.9%, and down nearly four percentage points from FY 1996 when property tax revenues as a percent of total revenues peaked in the 1990's at 49.0 percent. The relative decline in property tax revenues does not reflect weakness in that sector, but rather strong revenue growth in a number of other categories, particularly income taxes, especially over FY 1997 - FY 1999 period. In fact, construction in the County, while slowing recently, has been strong over the last few years and home prices are beginning to show some strength.*



County Income Tax Revenues Up 3.6% In FY 2000

☞ *County income tax revenues in FY 2000 totaled $403.7 million, up $13.9 million or 3.6% over FY 1999. If anything, the rate of change in County income tax revenues over the 1990's can be characterized as erratic -- strong gains one year followed by virtually no change the next (see graph below). The FY 2000 gain of 3.6% comes on top of increases of 7.5%, 15.3%, and 8.1%, in FY 1997 through FY 1999, respectively. However, in the three prior fiscal years (FY's 1994 - 1996), County income tax revenues increased by an average of only two percent annually. Only once over the last 30 years did income tax collections in the County fall -- FY 1971, a recessionary period, when collections dropped by 8.0% from the previous year. In the last recessionary period, FY 1991, income tax revenues advanced by only 0.3%.*

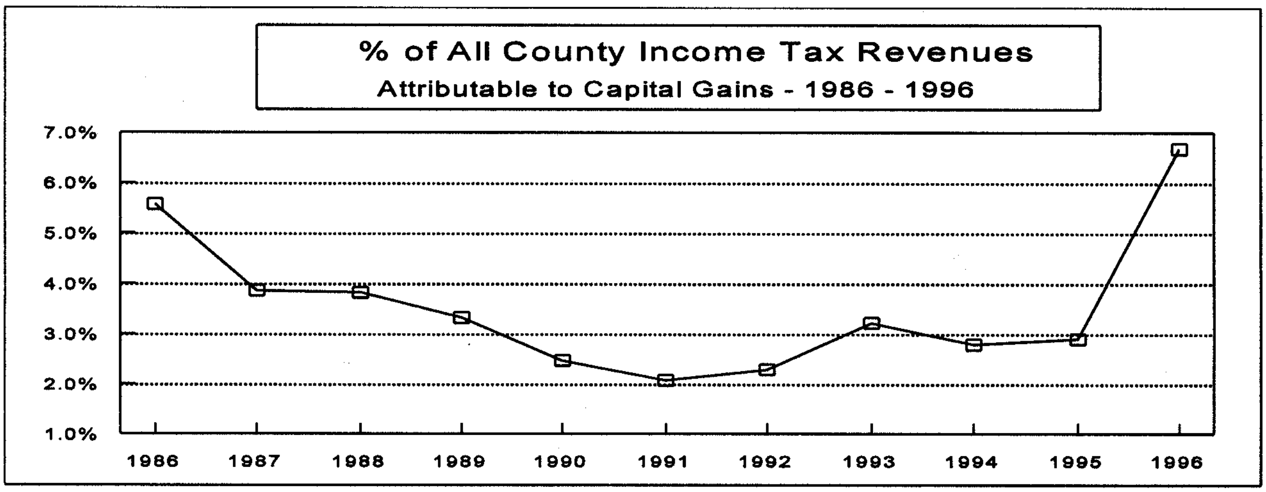
Percent Change in County Income Tax Collections: FY 1971 to 2000



☞ *Income tax revenues as a percent of County total revenues has been moving up steadily in recent years and in FY 2000, accounted for 35.6% of all revenues -- tying the record percentage set in FY 1999. During the early part of the 1990's, income tax revenues accounted for under 30% of all General Fund Revenues and in the early 1970's, income tax revenues were a little over 20% of total revenues.*

☞ *There has been considerable recent controversy on whether the strong showing in income tax collections has been the result of the booming stock market and increased income flows from capital gains collection or more a function of strong personal income gains. Capital gains taxation was liberalized in 1997 and from FY 1997 to FY 2000, County income tax revenues increased an average of 8.6%. The three fiscal years' prior, they increased by an average of only two percent annually. Thus, there appears to be a correlation between liberalized capital gains tax treatment, a strong stock market and County income tax collections. But, the most recent data available is for calender year 1996 and that shows estimated County income tax revenues from capital gains totaled $19.4 million (up from $8.3 million in FY 1995), accounting for 6.7% of all income taxes collected. It is interesting to note that for FY 1996, County total income tax revenues increased over FY 1995 collections by a total of only $6.2 million. Thus, without the additional capital gains revenues recorded in FY 1996, the County would have shown a drop in aggregate income tax revenues -- further supporting the argument of the erratic nature of income tax revenues.*

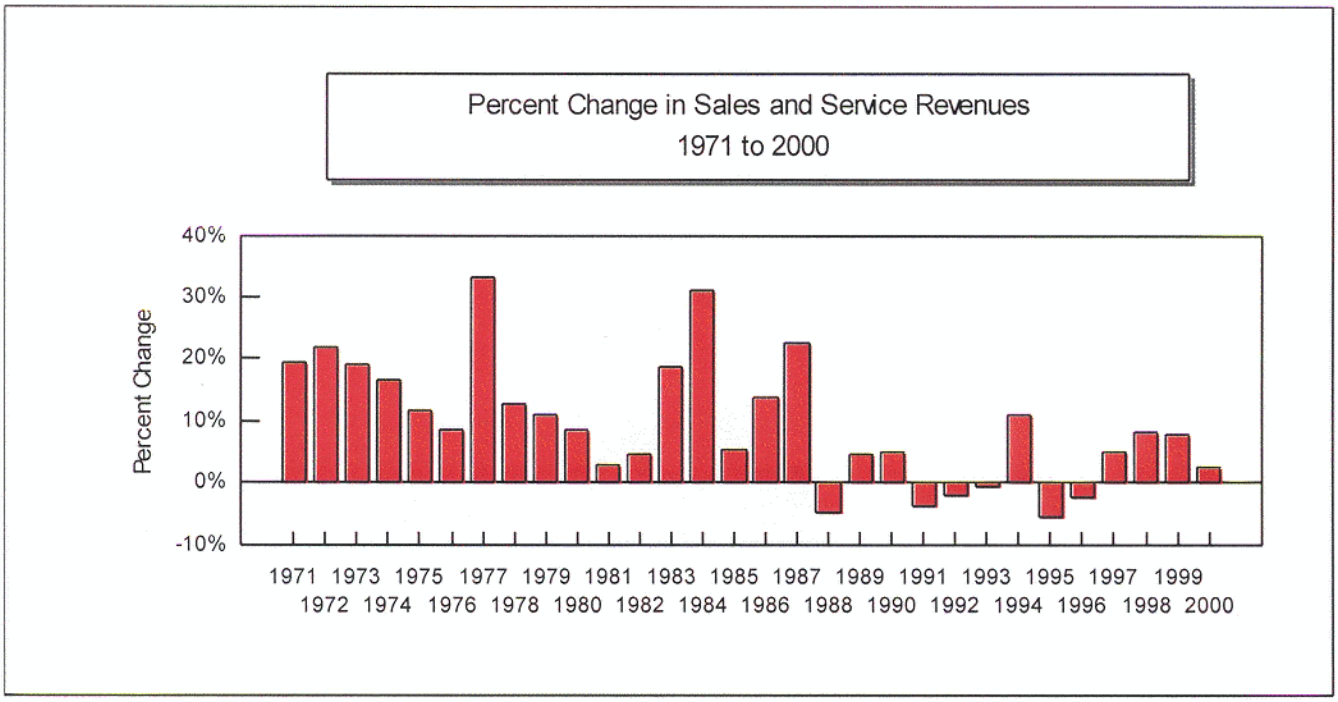
Percent of All County Income Tax Revenues
Attributable To Capital Gains: 1986 to 1996



☞ *Regardless of the sources of strength in income tax revenues, they represent a significant share of the net increase in total County General Fund revenues, however, that shared slipped in FY 2000 when income tax revenues accounted for only one third of the increase in total revenues. In FY 1999 and FY 1998, the additional revenues from income tax collections represented 45.8% and 70.3%, respectively, of the total net increase in County General Fund revenues.*

Sales and Services Revenues Up 2.6 % in FY 2000

☞ *Sales and services tax revenues set a record in FY 2000, totaling $98.8 million, up $2.5 million or 2.6%. Sales and services revenues represented 8.7% of all County General Fund revenues in FY 2000 and accounted for 6.1% of the total increase in General Fund revenues. Over half (54.1%) of the revenue generated in this category are attributable to the real estate sector, i.e., recordation and title transfer taxes. The real estate market was strong during the first half of FY 2000 and showed some modest declines in the second half. Consequently, for all of FY 2000, real estate related taxes were up by $1.0 million or by 1.9%. However, since real estate related taxes accounted for over one half of this category's revenues, sales and services taxes tend to show considerable fluctuations. Thus, while sales and services* *revenues may record an impressive gain one year, the following year may show a comparable decline (see graphic below). Additional highlights of FY 2000 Sales and Services revenues include: revenues from the sale of electricity, +3.7% or $0.6 million; admissions, +7.5% or $0.5 million; motel/hotel, +11.9% or $0.7 million, while telephone and auto trailer camp fees were off slightly for the fiscal year and 911 fees were flat.*



"All Other" Revenues Up 6.1% in FY 2000

☞ *"All other" General Fund revenues totaled $120.9 million in FY 2000, up $6.9 million or 6.1% over FY 1999. For the purpose of this analysis, the category "all other" combines all revenue sources outside of property, income and sales and services taxes. Some of the highlights from the "all other" category include:*

☞ ***Intergovernmental revenues** totaled $68.2 million in FY 2000, up $1.1 million or 1.6%. This increase reflects slightly higher State grants and higher State Shared revenues, mostly highway user funds, combined with lower federal grants of $1.0 million. Currently, intergovernmental revenues are at the same level as the mid-1980's, however, they are significantly below their FY 1990 peak of $78.9 million, but well ahead of their 1990's trough of $43.9 million in FY 1993.*

☞ *Revenues from County **investments** and owned property totaled $15.6 million in FY 2000, up only slightly over FY 1999. However, County revenues for **false alarm and red light citations** were up by $1.9 million and $1.0 million, respectively in FY 2000 over FY 1999.*

Fiscal Year 2001 Forecast

☞ *FY 2000 actual revenues of $1,135.6 million came in well ahead of the Adopted Budget (see Table on the following page) but slightly behind our revised revenue estimates. The revenue short-fall from the revised estimates might be a function of timing for some income tax payments/collections. Based on unaudited data, the FY 2000 surplus totals approximately $133.8 million. The surplus consists of the following balances: Revenue Stabilization Reserve Account, $34.5 million; designated for FY 2001 Expenditures, $41.8 million; and Undesignated, Unreserved Surplus, $57.5 million.*

☞ *Expectations for FY 2001 are for another good year of revenue growth. The Adopted Budget projected FY 2000 revenues of $1,165.5 million, while the revised current FY 2001 General Fund revenue projection is $1,177.1 million. If FY 2001 General Fund revenues and expenditures materialize as projected, $1,177.1 million and $1,207.3 million, respectively, the total surplus at the end of FY 2001 could reach $103.6 million, including $36.5 million in the Revenue Stabilization Reserve Account.*

FY 2000 General Fund Revenues And The
Adopted Budget and Revised FY 2001 Revenue Forecast

		FY 2001 Forecast	
Revenue Source	FY 2000 Actual	Adopted Budget	Revised Estimate
		(Millions of Dollars)	
Property Taxes	$512.2	$525.4	$531.0
Income Taxes	403.7	424.3	430.0
Sales & Services Taxes	98.8	95.9	94.7
Investment Income	15.6	14.2	13.5
Intergovernmental	68.2	69.3	71.6
All Other	37.1	36.4	36.3
Total Revenues	$1,135.6	$1,165.5	$1,177.1

BALTIMORE COUNTY REVENUES, AND REVENUE ESTIMATES VS. ADOPTED BUDGET
(MILLIONS OF DOLLARS)

REVENUE SOURCE	ACTUAL FY 1998	ACTUAL FY 1999	ADOPTED[1] BUDGET FY 2000	**ACTUAL[2] FY 2000**	DIFF: ACTUAL - ADOPTED DOLLARS	DIFF: ACTUAL - ADOPTED %
PROPERTY TAX	$475.9	$494.3	$504.8	**$512.2**	$7.4	1.5%
INCOME TAX	360.6	389.8	390.1	**403.7**	13.6	3.5%
SALES AND SERVICES						
ELECTRICITY	15.4	16.1	16.3	**16.7**	0.4	2.5%
TELEPHONE	11.2	11.4	11.7	**11.3**	-0.4	-3.4%
RECORDATION	18.1	18.9	16.2	**19.5**	3.3	20.4%
TITLE TRANSFER TAX	30.0	33.5	30.4	**33.9**	3.5	11.5%
OTHER	14.5	16.4	16.4	**17.4**	1.0	6.1%
TOTAL	89.1	96.3	91.0	**98.8**	7.8	8.6%
LICENSES AND PERMITS	4.0	4.0	4.1	**3.9**	-0.2	-3.7%
FINES, FORFEITURES & PENALTIES	3.5	2.6	9.2	**6.0**	-3.2	-34.8%
INVESTMENTS	12.4	15.5	13.8	**15.6**	1.8	13.0%
INTERGOVERNMENTAL						
STATE SHARED REVENUE	30.6	34.7	30.7	**35.4**	4.7	15.3%
STATE GRANTS	28.4	28.6	29.9	**30.0**	0.1	0.3%
FEDERAL GRANTS	4.5	3.8	2.7	**2.8**	0.1	3.7%
TOTAL	63.5	67.1	63.3	**68.2**	4.9	7.7%
SERVICE CHARGES/CRNT SVCS.	6.6	6.5	7.0	**3.8**	-3.2	-45.7%
OTHER	15.6	18.3	16.1	**23.4**	7.3	45.3%
TOTAL	$1,031.2	$1,094.4	$1,099.4	**$1,135.6**	$36.2	3.3%

1. At the time of the adopted budget, FY 1999 General Fund revenues were forecast at $1,086.7 million
2. Actual -- As of August 22, 2000